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Reply Comments of American Consumer Institute
Center for Citizen Research
Regarding Docket No. RM2017-3
Submitted to the United States Postal Regulatory Commission
March 30, 2018

The American Consumer Institute ("ACI") hereby submits its reply in response to comments filed with the United States Postal Regulatory Commission's ("Commission") respecting the Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.

INTRODUCTION AND DISCUSSION

The American Consumer Institute is an independent organization founded in 2005. The Institute's mission is to identify, analyze and project the interests of consumers in selected legislative and rulemaking proceedings in information technology, health care, insurance, postal and other matters.

In our initial comments in this proceeding, we noted that the financial and quality of service problems facing United States Postal Service ("USPS") were not due to the current price cap mechanism, but due to failures within the USPS management itself.[1] Because the USPS does not use a full cost accounting method, it is incented to engage in affiliate transaction abuses – including shifting revenues and profits from market dominant services to competitive services, as well as shifting costs and risk from competitive services to market dominant services.

The empirical evidence confirms this finding. In our comments, we provide the USPS' own data which show that competitive products now account for nearly half of truck delivery weight, which implies that, by volume, USPS likely deliver more competitive products than market dominant products.[2] This evidence, along with fact that competitive products receive priority service over First Class Mail and are the only products delivered on Sundays, demonstrates that mail delivery has become secondary.

[1] "Comments of American Consumer Institute, Center for Citizen Research," Docket No. RM2017-3, submitted to the Postal Regulatory Commission, February 23, 2018.
[2] Ibid, p. 6.

In other words, the core mission of the USPS – to deliver mail – has become subordinated by delivery of its competitive services. The USPS' very existence was established to provide monopoly postal services, but it has opted to spend extensively on labor, capital and services for the provision of products and services already available to consumers in the private sector, and then recover these competitive costs through overpricing its monopoly services. The proposed changes to the price cap mechanism enables these financial shenanigans.

While the USPS has made a transformation away from delivering mail to delivering expediated packages, for example, its cost structure has not made this transition. The undisputed fact is that the USPS' competitive products contribute only 8 cents for every dollar of revenue toward its fixed and institutional overheads, while market-dominant products contribute 58 cents for every dollar.[3] It is apparent that its monopoly services are being used to fund its competitive services. This comes as other price cap regulated firms in other industries are subject to strict affiliate transactions rules that require its competitive entities to "pay the higher of either the prevailing market price or fully allocated price."[4] The USPS violates this rule.

Therefore, the plan proposed in this NPRM serves to accelerate rate increases on market-dominant services and would exacerbate this cost shifting abuse and undermine what should be the USPS' sole mission.

These facts should persuade the Commission that the USPS' competitive services should be carrying the bulk of fixed and institutional overhead costs, but they are not. Correcting this imbalance in cost recovery is paramount. To do otherwise enables a misallocation of resources, permits an ongoing abuse of affiliate transactions, and overburdens market-dominant services, now in decline.

DECLINING VOLUMES ARE NOT AN EXCUSE FOR MISMANAGEMENT

The USPS frequently points to declining volumes of business as the reason why a price cap mechanism should be changed, but it is precisely why it shouldn't be changed. Total factor productivity is the ratio of total weighted volumes of business divided by total weighted factor inputs – labor, capital, material, rents, energy, services and so on. As volumes decline, the USPS has a responsibility to manage its inputs accordingly. If its productivity exceeds zero percent (the productivity X-Factor), it can keep the surplus earnings. That is how price caps are supposed to work.

Other price cap companies have managed declining volumes, while increasing earnings. For example, local exchange telephone companies have experienced dramatic decreases in business volumes – access lines, telephone calls and minutes of use. From 2000 to 2008,

[3] Ibid, p. 5.
[4] Ibid, p. 8.

incumbent telephone lines decreased by over 35%.[5] At the same time, price caps required these companies to make real (inflation-adjusted) decreases in service prices. Today, most public phone service and telephone directory service lines-of-businesses are no longer provided by incumbents, and only 5.9% of U.S. households have a wireline telephone service without a wireless service.[6] More than half of the states no longer require incumbent local exchange carriers to be the provider of last resort.

Price caps were the necessary transition mechanism that moved price regulated companies to a fully competitive market. USPS' frequent observation that price caps are unfair due to declining volumes is an excuse. They were afforded an opportunity to improve operational efficiency and beat the low national rate of inflation but failed.

Keep in mind that the other price cap companies cited here faced market entry and stiff competition in the local, long distance and carrier services market, but the USPS' faces no direct competition for its market-dominated services. Referring to the current price cap system as "wholly unsuited," just shows that the USPS is not ready for additional pricing flexibility, particularly when it enjoys a monopoly for these very services.[7]

SUMMARY

The Commission's recent news release identified several compliance issues with workshare discounts, market-dominant products and service performance, noting that the USPS "does not have a comprehensive plan to measure, track, and report flats cost and service issues," and that "additional transparency is necessary in these areas to hold the Postal Service accountable."[8]

We believe the Commission's findings noted here are just the tip of the iceberg. If costs were allocated properly, the Commission would likely find that some market-dominated services currently deemed to be in financial trouble are actually profitable, while some competitive services may well turn out to be below water. Why would the Commission not want to know this before deciding the very questions it raises in this NPRM?

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[5] "Trends in Telephone Service," FCC, Industry and Technology Division, Wireline Competition Bureau, September 2010.

[6] This figure includes access lines provided by both competitors and incumbents. Stephen J. Blumberg, Ph.D., and Julian V. Luke "Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, January–June 2017," U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Health Statistic, Division of Health Interview Statistics, Released 12/2017, Table 1, at https://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201712.pdf.

[7] "Initial Comments of the United States Postal Service in Response to Order No. 4258," United States Postal Services, Docket RM2017-3, filed with the United States Postal Commission, March 1, 2018, p. 1.

[8] "PRC Directs USPS to Address Compliance Issues in FY 2017 Annual Compliance Determination: Report shows progress in some areas and continued challenges in others," United States Postal Commission, News Release, March 29, 2018, https://www.prc.gov/press-releases/prc-directs-usps-address-compliance-issues-fy-2017-annual-compliance-determination.

The Commission needs to find a workable policy that benefits consumers of traditional postal service products. In the interim, we recommend requiring the USPS to increase its prices on competitive services. That would improve its financial condition within the scope of the current price cap mechanism. In addition, we recommend a full cost accounting system guided by strict affiliate transaction rules, as we described in our earlier comments. These recommendations are consistent with accounting systems and regulatory rules used in the past for many other regulated industries as noted earlier, including many price capped industries. This improvement would bring about the transparency that the Commission should want, and it will end affiliate transaction abuses.

A full cost allocation model would provide management with the correct information to judge whether market dominant services need price increases or whether certain competitive services should be discontinued or expanded. The obvious cost shifting underway simply undermines the USPS' core mission and it harms consumer welfare.[9] The Commission should not stand for this.

For the public interest, we conclude that the USPS management is operating without having the correct information it needs to make sound business decisions. Moreover, the Commission does not have the right information it needs to regulate and revise the current price cap mechanism as part of the 10-year review.

Therefore, we urge the Commission to make these changes and collect the information necessary to properly analyze the data before making any further decision in this matter.

Respectfully submitted,

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Attachment

[9] See Liam Sigaud, Before Raising Rates, Postal Service Should Address Mismanagement," Morning Consult, March 23, 2018, at https://morningconsult.com/opinions/before-raising-rates-postal-service-should-address-mismanagement/.

ATTACHMENT

Before Raising Rates, Postal Service Should Address Mismanagement

After years of soaring deficits, including $2.7 billion in losses in 2017, the United States Postal Service's financial condition continues to worsen, and a recent proposal by federal regulators fails to address the root of the problem.

The Postal Regulatory Commission (PRC), which has oversight authority over the Postal Service, is considering authorizing substantial postal rate increases over the next five years in an attempt to bolster the Postal Service's financial stability. Yet the PRC's proposed remedy is misguided and premature. Before the Commission contemplates increasing rates on the American people, it should examine the financial mismanagement that has brought the Postal Service to where it is today.

Since its founding in 1775, the Postal Service's core responsibility has been to deliver letter mail, a mission for which Congress has granted it a monopoly. These so-called "market dominant" services are generally profitable, generating $2.16 in revenue for every dollar in attributable costs, according to a recent report.

In addition to the market dominant services it provides, the Postal Service offers a broad range of competitive services -- such as issuing money orders, delivering food, and shipping packages -- which are also offered by private entities.

These competitive services account for 30 percent of the Postal Service's revenue, but federal law only requires them to cover 5.5 percent of the agency's fixed and institutional costs -- expenses like delivery infrastructure, administrative support, and building maintenance which cannot be attributed to a particular product or service. As a result, market dominant services shoulder a far greater share of these overhead costs. The inequity is so extreme that market dominant services pay 58 cents per dollar of revenue toward fixed and institutional costs, while competitive services pay only 8 cents per dollar of revenue.

This strongly suggests that the Postal Service may be using the profitability of its market dominant services to prop up competitive services which are struggling in the face of market rivalry from private companies.

But why, if the central mission of the Postal Service is to deliver letter mail, should it be carrying an additional cost burden for the benefit of non-essential competitive services? Surely the only possible justification for offering competitive services at all would be if those services were able to contribute an equal or larger share of overhead costs, so as to protect the financial stability of market dominant services. To allow competitive services to freeload off the profitability of market dominant services is to ignore clear congressional directives about what the Postal Service's priorities ought to be.

This cost-shifting needs to stop. Either the Postal Service should demonstrate the profitability of its competitive services or they should be discontinued. If the Postal Service dropped its competitive services tomorrow, consumers would still have numerous options to purchase these services from rivals. UPS, FedEx, and DHL would still ship packages; Giant's Peapod, Instacart, and Fresh Direct would still deliver food; and existing financial institutions would still provide money orders.

On the other hand, there are no substitutes for the letter delivery that the Postal Service provides, and it is irresponsible to jeopardize this core function in order to support competitive services that are not pulling their own weight.

The Postal Service cannot keep running multibillion dollar annual deficits, which may ultimately require a taxpayer bailout, and ignore the financial mismanagement that has been allowed to fester for far too long. Americans deserve better.

Liam Sigaud writes for the American Consumer Institute, a nonprofit educational and research organization. For more information about the Institute, visit www.TheAmericanConsumer.Org.

Published in the Morning Consult on March 23, 2018, at https://morningconsult.com/opinions/before-raising-rates-postal-service-should-address-mismanagement/.